

# Submission to the Garnaut Review

April 2008



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## **Introduction**

Synergy would like to thank the Garnaut Climate Change Review for providing the opportunity to comment on the Emissions Trading Scheme (ETS) Discussion Paper.

The Electricity Retail Corporation (trading as Synergy) was established on 1 April 2006 as a result of the disaggregation of the State-owned electricity utility Western Power Corporation. Synergy is now the largest electricity retailer in Western Australia (WA), serving almost 890,000 customers on the South West Interconnected System (SWIS), located within the South West region of WA. Synergy is also the second largest retailer of natural gas in WA.

Synergy supports Government policies aimed at managing Australia's Greenhouse Gas emissions (emissions) and holds the view that an effective ETS will be a cornerstone of such a policy response. Synergy appreciates the critical role of the Garnaut Climate Change Review in providing strategic advice to Government in developing a climate change response and in particular, deciding on the key features of the Australian ETS. In this submission, we provide the Garnaut Climate Change Review with our preliminary positions on the key issues raised in the Discussion Paper.

## **Synergy's Emissions Exposure and Mitigation**

As a result of the disaggregation process, Synergy's energy needs will initially be met by the State-owned Electricity Generation Corporation (trading as Verve) under a vesting arrangement. The coverage provided by these vesting arrangements will diminish over time, with the addition of new contractual arrangements and a progressive reduction of the existing contractual coverage. Critically, over the next 10 years Synergy will be required to recontract for an additional 2,200MW of electricity supply. This creates a significant direct and indirect exposure for Synergy with regards to emissions related costs.

As part of its energy procurement process, Synergy is devoting substantial resources to assessing the direct and indirect liabilities that may result from the implementation of an Australian ETS. To this end, Synergy would like to emphasise the imperative for the early establishment of a regulatory framework for the Australian ETS. This framework will allow business to make timely and economic investment decisions. In Synergy's case, there is a clear need for greater regulatory certainty prior to entering into long term energy supply contracts to provide electricity and natural gas into the retail market.

## **Impact of Regulatory Uncertainty**

The Western Australian Wholesale Electricity Market (WEM) design is fundamentally different from the design adopted for the National Electricity Market (NEM), which provides coverage for the vast majority of jurisdictions in the country. While the NEM is a gross pool, the WEM is a net pool design. Within the WEM, the majority of energy is traded via bilateral contracts which tend to be long-term in tenure. Entering into long-term electricity supply agreements imposes considerable risks. With the increasing level of debate about environmental issues at both the Federal and State levels over the past few years, and proposals by both levels of Government to address emissions; regulatory risks have now become one of the most prominent risks to be managed by Synergy when pursuing long term energy procurement including power purchase agreements and gas supply agreements.

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## **Need for Natural Gas**

While establishing the Australian ETS is an important first step in reducing emissions and providing regulatory certainty, clear leadership by the Federal and State Governments is required to ensure that sufficient 'clean' energy is available for domestic use – especially in the absence of cost-effective technology breakthroughs such as Carbon Capture and Storage (CCS).

In the current paradigm, natural gas will be the primary source of energy to provide low emission baseload power generation in Australia and provide the balancing power capacity necessary to support intermittent power supplies, such as those generated from wind and solar plants. However, recent gas price increases, coupled with the lack of long term gas supply, especially in WA, have threatened the role that natural gas can play in managing emissions. In WA coal is now emerging as the only cost effective fuel supply for the generation of baseload power.

As a member of the Domgas Alliance (who have also made a submission to the Garnaut Review) Synergy supports the Domgas Alliance's calls for the Garnaut Review to consider recommending to the Federal Government, measures that ensure the future supply of competitively priced natural gas to the Australian economy.

## **Complimentary Schemes and Mechanisms**

Synergy supports an evolution to a simple, technology neutral, market based approach in reducing emissions. In the long run, with sufficient and diverse technologies for power generation from less emission intensive sources (renewables and CCS) and strong markets for offsets, such a market based approach will provide the most economically efficient outcome. However, Synergy notes the limitations with regard to commercially competitive and proven technologies through which emissions reductions can currently be achieved. As such, Synergy believes that there may be significant short term benefits to be accrued through the retention of a renewable energy target, such as MRET. Such schemes have been proven in providing a boost to the development and commercialisation of new technologies. Synergy sees it as critical that any scheme has national coverage, allowing participants to seek the best commercial outcome, regardless of geography/jurisdiction. The MRET scheme should be established as a transitional mechanism, with assessment of its future role undertaken prior to arriving at each gateway, as defined in the Australian ETS framework.

Synergy sees a clear need for a range of complimentary schemes to support Government's emissions mitigation policy objectives. These schemes will seek to ensure that all sectors of the economy and members of the populace are incentivised to contribute to tangible reductions in emissions. Potential schemes include household energy efficiency schemes and schemes aimed at reducing product mileage (the distance products are transported before reaching the consumer).

Clearly, as established above, there is also a case for certain technologies, which are currently uncommercial, to be developed so they may achieve economies of scale or are refined so they may meet commercial standards. Above and beyond MRET, Governments can strategically develop and encourage the use of certain technologies by providing funds as an investor (loss leading or otherwise) or by way of grants. Synergy believes that the use of Government funds is a legitimate mechanism for achieving an emissions outcome, while allowing other investors to

continue following the least cost curve and avoiding placing an undue burden on other investors.

### **Scheme Coverage**

Synergy believes the Australian ETS should have the greatest possible coverage, that is, the six UNFCCC gases as well as the inclusion of all sectors, as and when they can be economically included within the Australian ETS framework.

Not including certain sectors (for example, agriculture and forestry) as liable sectors under the Australian ETS places additional pressure on the liable sectors to achieve a targeted emissions outcome. As such, the inclusion of all major sources of emissions as soon as is practicable should be a priority in the development of the ETS framework.

The inclusion of forestry should be considered on two fronts:

- Emissions from deforestation (or similar) projects need to be measured in context of net emissions. That is, the emissions from deforestation may be lower than the amount of carbon stored in the trees and some carbon remain stored in wood producing products – e.g. furniture.
- The forestry sector's ability to act as a producer of offsets should be treated independently from emissions liabilities that may result from deforestation activities. Synergy views forestry based offsets as one of the vital technologies that currently exist and allow businesses to offset their emissions.

Certain businesses can be classified as Trade Exposed and/or Energy Intensive. Synergy advocates that these businesses receive exemption from liabilities under an ETS, on a case by case basis, and that this exemption should be reviewed periodically.

### **Domestic Offsets**

Synergy agrees that domestic offsets from emissions sources, not otherwise covered under the scheme, have a role play in the Australian ETS.

Synergy strongly believes that to the extent possible, the Garnaut Review should recommend the adoption of the standards applied under Greenhouse Friendly Scheme (GF), or the GGAS standards where the GF standards are inadequate. Changes to standards should only be made in cases where the standards are not in compliance with the Kyoto Protocol (or successor UNFCCC frameworks).

Australia's position as a leader in the provision of forestry-based offsets provides an ideal opportunity to ensure that the high standards achieved to date are maintained and to provide certainty to businesses in regards to a regulatory framework.

### **Point of Obligation**

Synergy agrees that point of obligation should be determined by the ease and accuracy of monitoring and estimating emissions, and the associated cost of doing so.

### **Method of Permit Release: Auction or Allocation**

Synergy supports the auction and/or limited free allocation to existing generators to compensate for any adverse economic impacts incurred through the change of law. However, Synergy cautions against the provision of free grants for the full requirement for existing generators. Immediate full coverage will provide these

incumbent generators with no incentive to reduce emissions. In addition, support provided to incumbent generators should not be such that emitters using inefficient technologies have an economic advantage over new entrants using more efficient, less polluting technologies.

### **Emissions Trajectories**

Synergy believes that aside from a desired emissions outcome (which is dependent on political will and the mandates from the UNFCCC frameworks), the emissions trajectory should be driven by factors such as:

- Sectors included: If the scheme does not have wide coverage in the beginning, then undue pressure could be placed on included sectors to achieve the emissions outcome,
- Technologies available / commercialised: It is likely that the development timeframes of technologies will change over time and the emissions trajectory may need to be altered to allow for this,
- Synergy agrees that there should be flexibility built into the emissions trajectory, this will ensure that the right balance between stringent interim targets and achievable outcomes is maintained and the targets will be based on more accurate information as it becomes available.

### **Price Ceilings and Penalties**

Synergy believes that while price ceilings should be avoided to the extent possible, in the case of the Australian ETS it may be necessary at least in the first few years to provide the market with an 'outlet valve'. This would allow market participants to discover the price of credits without risking very high carbon prices which could result due to unforeseen events for example a fundamental flaw in certain market assumptions.

Synergy believes that the use of 'lending' as described by the Garnaut Review could provide the market authority with a powerful tool in managing emissions from those parties that fail to meet their obligations in certain years. However, the use of lending should be restricted to cases where it is highly likely that the credits will be produced and should be done on a project by project basis. An obvious example of this would be forestry based offsets where the sequestration profile of the plantation is not linear, but the project is being used to offset liabilities that are linear (for example the emissions profile of a power station).

Synergy believes that in order to avoid the cost and complexity of a large scale monitoring program that would be associated with lending, the authority should have discretionary powers to enforce penalties in cases where a party has failed to meet its obligations and is unlikely to meet these obligations unless it uses the market itself to procure offsets.

### **Banking and Borrowing**

Synergy agrees with the Garnaut Review's view that unlimited hoarding (banking) should be allowed.

Synergy considers that the issue of borrowing is critical and should be examined in greater detail before it is rejected or included within an Australian ETS framework. Borrowing could have an important role to play in the Australian ETS as it creates flexibility for investors who may otherwise not be able participate in the market. However, Synergy also appreciates that several key issues would need to be overcome before borrowing would be acceptable. These issues include:

- Risks to the credibility of the Australian ETS in the event that the market overall has short-sold credits to a level that it can not produce in the future,
- There is a risk that borrowing could act as a distortion in or hindrance to the development of a forwards market because investors may attempt to game the primary and/or secondary markets,
- There is an increased risk of fraud generally if unscrupulous parties borrow credits which are never going to be created,
- The scheme should recognise and account for the fact emissions reductions in a given year would have a greater impact on reducing climate change than reductions which take place in following years.

Synergy believes that borrowing should only be rejected if the above risks cannot satisfactorily be dealt with through scheme design and the likely impact of the borrowing as result would outweigh the benefits of borrowing.

### **International Linkages**

The ability to link the Australian ETS with international schemes either directly (for example as proposed with the New Zealand scheme) or indirectly (for example through the CDM and JI mechanisms) will give buyers and sellers additional choice and such linkages should be promoted to the greatest extent possible. However, care needs to be taken in ensuring that credits procured internationally, to acquit liabilities in Australia, meet standards imposed under the Australian ETS framework.

### **Compensation for Changes in Income Distribution**

Synergy agrees that the aim of the Australian ETS is not to create changes in income distribution. As such, whilst the recognisable aim of changing consumer behaviour is a strong element of the Australian ETS, vulnerable consumers who are disproportionately affected should be protected. Synergy believes that the funds required for this purpose should be provided from the penalty revenue of the Australian ETS and in the absence of this revenue, be provided by the Government.

Further, the Garnaut Review should encourage the Government to enact strong legislation to protect consumers from parties who may wish to use the Australian ETS as pretext to raising prices beyond what would ordinarily be the case.